DOCUMENT RESUME

ED 302 289 JC 890 014

TITLE	The Guaranteed Student Loan Program in the California Community Colleges. Report and Recommendations of the Financial Aid Policy Task Force.
INSTITUTION	California Community Colleges, Sacramento. Office of the Chancellor.
PUB DATE	Jan 89
NOTE	30p.
PUB TYPE	Reports - Research/Technical (143)
EDRS PRICE	MF01/PC02 Plus Postage.
DESCRIPTORS	Federal Aid; Federal Legislation; Financial Aid Applicants; Financial Support; Grants; *Loan Repayment; Need Analysis (Student Financial Aid); *Program Administration; Program Improvement; State Aid; State Legislation; *Student Financial Aid; Student Financial Aid Officers; *Student Loan Programs; Two Year Colleges
IDENTIFIERS	*California; *Guaranteed Student Loan Program

ABSTRACT

This report on the Guaranteed Student Loan (GSL) Program in the California community colleges discusses the repayment of student loans and recommends strategies for reducing default rates. Introductory material highlights the following trends: (1) financial aid programs for low-income students have failed to keep pace with demand; (2) by 1983, loans represented 41% of total financial aid dollars; and (3) default rates on GSL loans in California increased from 12.4% in 1983 to 33.1% in 1988. Chapter 1 examines the reasons students borrow money to pay direct college costs; the structural factors that influence who borrows and the amount borrowed; and the role of borrowing in financing students' education. Brief discussions are also presented of the roles of lenders and financial aid administrators in the borrowing process. Chapter 2 reveals that the majority of those who default on loans are students from very low income homes, who have no alternative to borrowing to finance their education, who fail to achieve academic success, and who find themselves in worse economic circumstances after attending college and accumulating a sizeable debt to pay. Chapter 3 looks at the institutional, state and federal actions taken in recent years to curb default rates, and countervailing actions that undermine the effectiveness of such efforts. Chapter 4 shows that while community colleges have reduced the number and volume of loans, the default rate continues to increase. Finally, recommendations for reducing default rates are presented, focusing on loan administration, counseling, access, and federal and state funding. (AJL)

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ED302289

The Guaranteed Student Loan Program in the California Community Colleges

Report and Recommendations of the Financial Aid Policy Task Force

January 1989

Chancellor's Office
California Community Colleges
Sacramento, California

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TABLE OF CONTENTS

	Page
FOREWORD	i
INTRODUCTION	1
CHAPTER 1	
Why Students Borrow	3
The Role of Lenders	4
The Role of Financial Aid Administrators	4
CHAPTER 2	
Who Defaults?	5
Findings in California	5
Findings from National Studies	6
High-Risk Students	6
CHAPTER 3	
Actions Taken to Curb Defaults	9
Changes at the Institutional Level	9
Changes at the State Level	10
Changes at the Federal Level	12
Disturbing Counter Trends	14
CHAPTER 4	
Current Status of the GSL Program	17
Decreases in Community College Student Borrowing	17
Continuing Growth in Default Rates	17
The Need for Immediate Action	20
CONCLUSIONS	21
RECOMMENDATIONS	23

FOREWORD

The Financial Aid Policy Task Force was appointed in March 1988 by then-Chancellor John D. Randall. Its charge was to study and make recommendations on:

- Reducing default rates in the Guaranteed Student Loan (GSL) Program;
- Strengthening financial aid administration on community college campuses;
- Establishing related long-range policy directions.

These were issues that had been highlighted in an earlier staff report, *Financial Aid in the California Community Colleges*, which had been presented to the Board of Governors in December 1987.

The Task Force - whose membership is representative of chief executive, student services, instructional, and business officers; financial aid and EOPS directors; faculty; and students and is listed in the Appendix - convened in April 1988 for an overview of student financial aid programs and administration. During the meeting, the group:

- Reviewed the application and delivery process for federal and state financial aid (including the calculation of eligibility and financial need) and institutional policies determining the amount and types of financial aid a student receives;
- Looked at trends affecting financial aid for community college students; and
- Discussed the concern and debate surrounding student indebtedness, unmet financial need, and staff shortages and workload increases in campus financial aid offices.

The Task Force met again in May and June to focus specifically on the GSL program and default-reduction strategies. Those meetings and discussions form the basis for the report and recommendations that follow.

INTRODUCTION

Guaranteed Student Loans are a major source of financial aid for college students. As of September 30, 1988, California community college students had borrowed more than $505 million under the program. Nationwide, the total volume of loans had reached a staggering $68 billion.

The Guaranteed Student Loan (GSL) program was authorized in 1965. It was expanded under provisions of the Middle-Income Student Assistance Act of 1978 to respond to a growing demand for federal aid by middle-income families facing escalating educational costs. With federal grant dollars reserved for low-income students, the GSL program was designed as a convenient source of low-interest loans for those ineligible for grants.

Banks and other lending institutions make the loans directly to students. Repayment does not begin, nor does interest start to accrue, until six months after a student finishes school or is no longer enrolled at least half-time. The federal government, in conjunction with a designated state agency, guarantees repayment of the loan if the student defaults and pays the lender an interest subsidy until the student enters repayment status.

As originally conceived, the GSL program made good sense: Use a relatively small investment of federal dollars to leverage billions in private capital so that middle-income families could send their children to college. Since the program's inception, however, it has taken on a new role inconsistent with its structure.

The demand for financial aid to low-income students has risen sharply, but increases in funding for programs designed to help them have failed to keep pace. As a result, low-income students have been compelled to borrow to pay for their educations and GSLs have become a standard component of need-based financial aid packages. In 1976, loans comprised only 6 percent of the total financial aid dollars awarded to community college students in California. By 1983, loans had become the single largest source of aid - 41 percent of the total. This shift has had serious consequences.

In a report to the Board of Governors in October 1983, the Chancellor's Office warned about the rapid increase in GSL borrowing and urged action to stem the rising tide of defaults. At that time, community college students, collectively, had a gross default rate of 12.4 percent. Today, the default rate has reached 33.1 percent.

Significant changes in program policy and administration have been initiated at the federal, state, and local levels since 1983, but it will be several years before the results are reflected in the default rate. Although the program recently was renamed the Stafford Loan program, this report will continue to refer to it as the GSL program, because that name describes the nature of the program, and because it was during the years of the GSL program that the present default problem developed.

CHAPTER 1

Why Students Borrow

Students borrow because they need money to pay direct college costs and to support themselves so they can devote their primary efforts to pursuing an education. But certain structural factors in the GSL program influence who borrows, the amount they borrow, and the role of borrowing in financing students' educations.

Today's default rate is the product of program policy in effect from 1979 through 1986. During that period, GSLs were by far the easiest type of financial aid to obtain. The GSL application, readily available from commercial banks and a number of other sources, was a simple one-page form with instructions on the back. This was in marked contrast to the Student Aid Application for California (SAAC) - a four-page form with 12 to 16 pages of instructions - required for all other types of financial aid.

Initially, there were no need criteria or income restrictions on eligibility for a GSL. Later, beginning in 1982, students with family incomes above $30,000 a year had to demonstrate financial need. Other than that, it was only necessary to complete a section of the short form and have a section completed by the financial aid office, which certified that the student was enrolled for at least six units. The form was then returned to the lending institution, which processed it through the Student Aid Commission (the guarantee agency for California) and then issued a check to the school to be given to the student. This process could usually produce a check to the student in much less time (one to two weeks) than was required to process applications for other types of aid (six to eight weeks).

Furthermore, a Guaranteed Student Loan - at $2,500 the largest annual award of any aid available to community college students - was given to the student in one lump sum for the year, at the beginning of the school term. Grant funds, on the other hand, were doled out in multiple payments, ranging from once a semester to once a month depending on school policy.

Because first-time college students plan to be in school for several years and often have unrealistic expectations about their earning power after graduation, the distant prospect of having to repay the loan tends to be outweighed by the ease of obtaining it. And as grant funds became increasingly inadequate, many low-income students needed all the grant and work study aid available to them in addition to the loan to stay in college.

The Role of Lenders

Lending institutions encourage GSL borrowing because they are guaranteed a return on their investment. Not only is the lender insured against default, and receives an in-school interest subsidy, it also is paid a special allowance - currently at the 91-day Treasury Bill rate plus 3 1/4 percent - during in-school, grace, and deferral periods. While profit margins - 1 percent according to one major lender - may be lower than for alternative investments, GSLs are a viable part of a lender's overall investment portfolio.

Lenders historically have been resistant to administrative controls over their actions in the program. Some loan practices have been open to question, seeming to do little to discourage default. Borrowers have not always received adequate notice that their loans were about to become due, nor have they been informed consistently about deferral procedures. Many lenders regularly sell GSLs to secondary markets as soon as they are made, creating confusion and communication problems for students who find they have become obligated to financial institutions of which they have never heard. Further, some lenders and secondary markets have made minimal efforts to collect before declaring loans in default and turning them over to the guarantor for payment.

The Role of Financial Aid Administrators

Financial aid officers are well aware of the default problems associated with GSLs, and most do their best to discourage borrowing. However, they have little control over the matter. Until 1986, the role of the financial aid officer was restricted to certifying the student's enrollment and, if the student was receiving other financial aid, ensuring that the amount of the loan would not result in a student's total aid package exceeding the amount of his or her calculated financial need.

Recent changes have given financial aid officers more responsibility in awarding GSLs - determining every student's financial need and verifying that he or she is maintaining satisfactory academic progress, enrolled in an eligible program, and does not have a past history of default. However, these changes have not added any authority over the program. The GSL is still an agreement between the student and the lending institution. As long as the borrower meets federal criteria, the financial aid office has no authority to deny a loan, regardless of how prudent such action might be.

CHAPTER 2

Who Defaults?

A number of state and national studies have been conducted to determine the characteristics of students who fail to repay their GSLs. Default rates are significantly higher among community college and two-year proprietary (for profit) school borrowers than for borrowers attending four-year colleges and universities. However, the California Student Aid Commission has found that those who default share some important characteristics in common, regardless of the institutions they attend.

Findings in California

Factors that show a high correlation between borrowing and default are educational level attained and family income at the time the loan is made.[1] Students who default are likely to have borrowed only as first-year undergraduates and to have taken out only one loan. The average amount of a defaulted loan in California is $2,871. Of all students who default, 65 percent borrowed their last loan as first-year undergraduates, and 82.4 percent took out only one loan. The Student Aid Commission report concludes, "Taken collectively, these findings suggest that many defaulters enrolled for only a single year or part of a year, and then probably failed to complete their planned educational program."[2]

The other significant characteristic of students who default is low family income. Of all California students who defaulted on their GSLs, 65.5 percent had gross family incomes of $10,000 or less at the time they took out their first loan, while only 4.3 percent had family incomes of $30,000 or higher. *Of all community college borrowers who defaulted, 71.6 percent had family incomes of $10,000 or less, and only 2.3 percent had family incomes of $30,000 or more.*

1. California Student Aid Commission, Student Borrowing in California, *A Report on Student Participation in California's Educational Loan Program* Sacramento, March 1988.

2. Ibid, p. 46

Findings from National Studies

These findings are consistent with the results of research conducted in several other states, and with a General Accounting Office (GAO) study of characteristics of students who borrowed and defaulted nationally.[3] The GAO report indicates that the highest rates of default are among independent students who have family incomes of less than $10,000, students who attend proprietary vocational schools, and students who are enrolled for one year or less.

The majority of students who default are located during the collection process but state they are simply unable to pay according to a representative of one major lender, who participated in a 1986 task force of community college financial aid officers and Chancellor's Office staff considering default-prevention strategies. According to other research, some significant causes of default are unemployment, underemployment, or employment in low-paying jobs at the time of repayment. A 1984 study by the New York State Higher Education Service Corporation found that 66 percent of those who defaulted were unemployed when their loans came due, according to the Belmont Task Force.[4]

High-Risk Students

These findings challenge the stereotype that the student who defaults has amassed enormous debt and then skipped town to avoid repayment. There are deadbeats, to be sure, and financial aid officers deplore their lack of authority to deny loans to those they can identify early on. But the majority of those who default are students from very low income homes who have no alternative to borrowing to finance their education, who fail to achieve academic success, and who find themselves in worse economic circumstances after attending college than before because they now have a sizeable debt to pay. As of 1986, those who default are ineligible for any federal Title IV or state Cal Grant aid, effectively closing the door to any future educational endeavors.

3. United States General Accounting Office, *Defaulted Student Loans: Preliminary Analysis of Student Loan Borrowers and Defaulters*, Briefing Report to the Chairman, Subcommittee on Postsecondary Education, Committee on Education and Labor, House of Representatives, June 1988.

4. *Belmont Task Force Recommendations, Final Report to Congressman Pat Williams, Chairman of the House Subcommittee on Postsecondary Education*, February 1988. The Belmont Task Force was convened by Congressman Williams to examine the evolution of the GSL program, to assess its viability in relation to its costs, and to make recommendations for reducing the cost of defaults. The Task Force was composed of representatives of lenders, guarantee agencies, postsecondary institutions, students, financial aid officers, secondary loan markets, congressional staff, and the U.S. Department of Education.

In its report, the Belmont Task Force concluded:

> Contrary to popular perception, the typical defaulter is not a "deadbeat" who refuses to pay, but appears to be a dropout who is unable to pay. Defaulters tend to be first year students, from low income and minority backgrounds, with a small loan balance (90 percent less than $5,000) who did not complete much more than the first year, have borrowed only once, receive no or little assistance from parents in repaying, are likely to be unemployed when the loans come due, and never make a first payment. The present default problem is thus predominantly structural.[5]

The Student Aid Commission report attributes high default rates at community colleges and proprietary schools primarily to the high-risk characteristics of their student populations and only secondarily to institutional policies and practices. The report cautions against eliminating eligibility for students with such characteristics, pointing out that even the majority of borrowers fitting that profile do repay their loans. Fifty-four percent of all community college borrowers who repaid or are repaying their loans had family incomes of $10,000 or less. And, 61.6 percent of those who repaid took out their only loan in their first year. To deny loans to all students with high-risk characteristics would deal a serious blow to educational equity.

5. Ibid, p. 8.

CHAPTER 3

Actions Taken to Curb Defaults

Changes at the Institutional Level

Financial aid officers have sought to limit borrowing since the GSL program first took hold among community college students. The Chancellor's Office 1983 report to the Board of Governors precipitated a series of in-depth articles in the *Sacramento Union*, and Chancellor's Office staff began consulting with local colleges in earnest about default-prevention strategies.

As early as 1984, some community colleges began requiring all GSL applicants to complete the SAAC form as a prerequisite for certification of the GSL application. This had the effect of bringing the GSL process in line with other financial aid programs, discouraging students from opting for a GSL simply because it was the easiest way of obtaining aid. This procedure also encouraged students to take advantage of grant and work-study aid as an alternative to loans, once they demonstrated eligibility for the former.

Initially, the colleges were advised by the U.S. Department of Education that this practice was not authorized, but they persisted and won the backing of the California Student Aid Commission for continuing the requirement. By 1986, at least half of the community colleges had adopted this policy. Most colleges also began requiring borrowers to demonstrate satisfactory academic progress as a condition for receiving loan disbursements.

Colleges took other informal actions, including counseling students away from lending institutions with bad records of service to borrowers, barring on-campus solicitations by lenders, requiring students to provide references who could be later used to trace borrowers who moved and failed to inform the lender or financial aid office of a new address, assisting transfer students in fulfilling deferral requirements so as to avoid procedural defaults, and conducting pre-loan and/or exit interviews to inform or remind borrowers of their repayment obligations.

The first colleges to institute such default-prevention procedures were considered mavericks and met with resistance from government agencies, lenders, and students. A number of colleges skirted the edge of legality in their efforts to reduce the attractiveness of the GSL, going against federal program policy that encouraged rather than discouraged widespread borrowing. As soon as one or two financial aid offices would succeed in "getting away" with a new strategy, it would be popularized through informal networks and other colleges would follow suit.

But, these default-prevention activities required a substantial investment of staff time and resources, and where they were implemented, it was at the expense of other financial aid services to students. By and large, colleges did what they could within the constraints of the limited authority and limited resources available to them.

Changes at the State Level

In May 1985, the California Student Aid Commission adopted a Default Prevention Plan, the major features of which are outlined below:

- Regulations were adopted that authorized limitation, suspension, and termination (LS&T) action against schools that were found to seriously abuse the GSL program. General criteria used to evaluate institutions included unsatisfactory administrative performance in a Compliance Review, a gross default rate higher than 30 percent, or the commission of fraud or misrepresentation.

  LS&T actions have since been initiated against several proprietary institutions.

- An agreement was entered into with the U.S. Department of Education to participate in a pilot federal-tax offset program under which any income tax refunds due students who default are diverted to the Commission to the extent of their loan obligations.

  The Commission already had an agreement with the Franchise Tax Board to offset state income tax refunds. (The Chancellor's Office also participates in this program on behalf of districts to collect other student financial aid debts owed to community colleges. The Chancellor's Office Tax Offset Program (COTOP) has been highly successful in motivating students to begin repayment of their outstanding obligations. Districts cannot collect GSL defaults, however, because the money is owed to lenders or guarantee agencies, not to the institutions.)

- Annual notification to participating colleges and lenders of their default rates was initiated.

- The number of on-site school- and lender-compliance reviews was increased.

- A student consumer information program was established. Brochures, posters, public service announcements, and videos were produced to promote awareness of repayment responsibilities.

The Commission established the following requirements for lenders:

- Minimum standards of lender due-diligence were strengthened to specify required collection efforts during periods of delinquency, before the loan is defaulted and submitted to the Commission for payment.

- Minimum skip-tracing efforts and credit bureau reporting were mandated.

- Improved communication with borrowers prior to their entering repayment status was required to include an annual account statement during periods of school enrollment, a notice within 60 days prior to the expected graduation date, and a repayment disclosure within four months prior to the end of the six-month grace period after graduation.

The Commission established the following requirements for schools, colleges, and universities:

- Students were to be encouraged to apply for all other types of financial aid, with the GSL packaged as a last resort to meet remaining need after all other aid was awarded.

- Institutions were required to verify satisfactory academic performance on the part of borrowers before disbursing payments.

- Institutions were required to withhold student transcripts, records, or other services to students who were known to have defaulted on a GSL, to the extent permitted by law.

  At the time this proposal was adopted, California law did not permit public institutions to take such action. In September 1988, Chapter 1420 was added to the *Education Code* to grant this authority. As of January 1, 1989, community college districts are required to adopt regulations that provide for the withholding of services to any student in default. Services to be withheld may include, but are not limited to, the provision of grades, transcripts, and diplomas. Registration privileges cannot be withheld.

- Timelines were established for responding to students' requests for information about their loans and to lender or Commission requests for information about borrowers.

- A Commission brochure and a warning statement were required to be furnished to all borrowers.

The Commission added additional requirements for schools with high default rates:

- Pre-loan and exit interviews, and

- School assistance in collecting loans, including completion of quarterly Student Status Confirmation Reports and provision of addresses and/or enrollment information on all delinquent or defaulted borrowers.

  This requirement was modified from an earlier proposal that would have held schools responsible for contacting delinquent and/or defaulted borrowers to encourage them to make repayment arrangements. The original concept was opposed because it would have established an inappropriate, and probably illegal, role of a third party (the school) in a contractual agreement between the student borrower and the lender.

Some of these requirements were already standard practice for virtually all community colleges, and some colleges had already implemented all of those that fell within the boundaries of institutional control.

Philosophically, community college financial aid administrators welcomed these actions, with two reservations. First, there were no provisions made for the additional workload that would be generated. Given historical staff shortages and overload, and coming on the heels of new federal verification requirements for all Title IV aid programs that had already increased workload astronomically, financial aid administrators pleaded for additional resources.

The Commission recognized the problem and submitted a budget change proposal (BCP) for 1985-86 for an administrative cost allowance of $3 per GSL to participating schools. This request was rejected, however, by the Department of Finance and schools have had to absorb the additional workload. As a result, the delivery of other financial aid programs has suffered.

The second concern of financial aid administrators was that they were being made full partners in the GSL collection process but had no such status in the loan origination process. This remains a concern.

Changes at the Federal Level

In 1986, Congress took control of the GSL program, responding to its now massive costs in the context of federal budget constraints. The following changes were made through the Comprehensive Omnibus Budget Reconciliation Act (COBRA) and the Higher Education Amendments of 1986:

- The GSL was made a need-based program. In California, all borrowers must now file the SAAC or the Application for Federal Student Aid and have their financial need assessed before a loan will be approved.

- Lenders are now required to make multiple disbursements of loans, at least by term, instead of a single lump sum payment at the beginning of the school year.

  For students who fail to complete their first year of school, this change reduces the amount of the loan at risk for default by at least half. It also provides an incentive for students to stay in school. Financial aid officers have advocated this change in policy for several years.

- Ability-to-benefit provisions, which are applicable to all federal aid programs, were strengthened to require that students who are admitted without a high school diploma, or its equivalent, must either: (1) earn a GED by the end of the first year of enrollment or prior to certification or graduation from a program of less than a year's duration; or (2) be counseled prior to admission and be enrolled in and successfully complete a remedial program prescribed by the school within the cumulative equivalent of one academic year (30 semester units); or (3) be administered a nationally recognized, standardized, or industry-developed test measuring their ability to successfully complete their educational program. Students who fail to achieve a passing score are required to satisfy option 2 above.

  This change in policy is significant because of the high degree of correlation between program completion and loan repayment. Recent GSL program reviews conducted by the Student Aid Commission have devoted considerable attention to the implementation of these provisions. The Chancellor's Office has urged districts to consider these requirements in developing matriculation programs.

- Borrowers are now required to have been admitted to an eligible institution for enrollment in a degree, certificate, or other program leading to a recognized educational credential. They are also required to demonstrate satisfactory academic progress.

  This change extends existing policy for other Title IV aid to the GSL program.

- Exit counseling is required.

- Schools are prohibited from disbursing any Title IV aid to a student who has defaulted on a GSL at any institution previously attended.

- Administrative requirements for lenders and state guarantee agencies were strengthened.

These actions statutorily change the nature of the GSL program, bringing it technically in line with what it had already become, a need-based financial aid program, and ending the wild ride of several years, where there were virtually no

controls on borrowing or lending practices. But while these structural changes improve accountability, and some reduction in the default rate will eventually result, the new provisions formalize rather than rectify the essential contradiction that has given rise to the default problem.

Eligibility for middle-income students, for whom the program was originally intended, is restricted; instead, eligibility is reserved for low-income students, who were historically served with non-loan aid.

Disturbing Counter Trends

Certain countervailing actions and proposed actions threaten to undermine the positive effect of these efforts to reduce GSL defaults. Specifically, the following are of concern:

- Supplemental Loans for Students/Parent Loans for Undergraduate Students

  Although the Higher Education Amendments of 1986 imposed some control over the GSL program, the structure of the Supplemental Loans for Students (SLS) and Parent Loans for Undergraduate Students (PLUS) programs were left untouched while loan limits were raised. The SLS and PLUS programs are very similar to the original GSL program but contain features that are potentially more damaging. Interest rates are higher, as are loan limits in the first two years of study ($4,000 as opposed to $2,625 per year for a GSL) and aggregate loan maximums ($20,000 as opposed to $17,500).

  Repayment of a PLUS loan begins 60 days after it is made. Although repayment of SLS loans may be deferred while the student is enrolled, interest begins to accrue on the date of disbursement and can be capitalized as often as quarterly.

  The number of SLS and PLUS loans to community college students is still small, but SLS loans have increased by more than 700 percent since 1985-86 and the demand is growing.

- Promoting Borrowing

  For several years, student financial aid professionals in California, led by Chancellor's Office staff, have resisted efforts to include questions on the SAAC that might encourage borrowing or provide for the automatic determination of GSL eligibility. Such questions appear on SAAC-equivalent applications used by many other states.

The U.S. Department of Education announced earlier this year that it planned to add the GSL application itself as a fourth page to the Student Aid Report (SAR), the document that every Pell Grant applicant receives as notification and documentation of eligibility. The plan, which would amount to promoting loans to the financial aid applicants with the lowest incomes, was withdrawn in October due to an outcry from the financial aid community. It is likely, however, that this proposal will be advanced again in the future.

- Increasing Automation of Loan Processing

  The Student Aid Commission is far more advanced in its processing of loan applications than either it or the Department of Education is in the area of grants. Electronic processing between the Commission and major lenders has been in effect for several years and is being pursued between the Commission and colleges. As long as loans are easier and faster for students to obtain, they will continue to be a more attractive means of financing an education.

CHAPTER 4

Current Status of the GSL Program

Decreases in Community College Student Borrowing

Through recent efforts, community colleges have been effective in reducing the number and volume of student loans. Between 1982-83 and 1985-86, they were the only educational segment to do so, with a 3 percent decline in the number of loans and a 9 percent decline in dollar volume. During that same period, the number of loans to students at proprietary schools increased by almost 53 percent, at the University of California by 30 percent, at the California State University by 23 percent, and at four-year independent colleges and universities by 12 percent. The number of loans to community college students decreased even more dramatically from 1985-86 to 1987-88, by 43 percent. Data for the first quarter of 1988-89 show an additional 4.2 percent decline from the same quarter of the previous year.

Continuing Growth in Default Rates

While the dollar volume and number of loans have decreased, however, the default rate has continued to grow, as shown in Table 1 below. The cumulative gross default rate for community college students stood at 32.4 percent at the end of 1987-88, second only to the proprietary schools. As of September 30, 1988, the rate had climbed to 33.1 percent. This is more than twice the rate for CSU students and more than four times that for UC students.

Table 1

GSL Annual Volume and Gross Default Rate by Segment, 1982-83 to 1987-88

Segment	1982-83		1985-86			1987-88			Percent Change in Volume, 1982-83 to 1987-88
	Loan Volume	Default Rate	Loan Volume	Percent Change in Volume	Default Rate	Loan Volume	Percent Change in Volume	Default Rate	
Community Colleges	$69,890,000	6.8	$63,634,000	-9.0	31.2	$32,324,000	-49.2	32.4	-53.8
CSU	$75,905,000	5.2	$90,122,000	18.7	12.6	$78,961,000	-12.4	13.0	4.0
UC	$38,979,000	3.2	$48,707,000	25.0	7.5	$73,668,000	51.2	7.5	89.0
4-Year Independent	$64,798,000	5.3	$70,748,000	9.2	10.4	$184,834,000	161.3	10.4	185.2
Proprietary	$104,573,000	22.1	$158,174,000	51.3	32.2	$216,298,000	37.0	32.8	106.8
Total All California Loans	$387,781,000	7.9	$468,718,000	20.9	16.9	$665,525,000	42.0	17.3	71.6

Gross default rates for individual community colleges range from 6.2 percent to 61.1 percent, with the distribution shown in Table 2 below.

Table 2

Gross Default Rate	Number of Colleges
Less than 10%	1
10 to 20%	3
20 to 30%	45
30 to 40%	38
40 to 50%	14
More than 50%	4

The gross default rate is calculated by dividing the dollar value of total matured paper (loans due) into total dollars in default. Ironically, the reduction in loan volume for community college students has the immediate effect of escalating the default rate, because the volume of old loans going into default is out of proportion to the volume of new loans being made. Once a loan goes into default, it is never deleted from the gross default rate, even when part or all of it is eventually repaid. The Student Aid Commission also calculates a net default rate that reflects the results of collection efforts. That rate for community college students was 26.1 percent as of last September 30.

The US. Department of Education is currently using yet another method of calculating the default rate in assessing institutional performance. The number of borrowers who enter repayment status in any given year is divided into the number who default within that or the next fiscal year. This calculation is more sensitive to default-reduction efforts by the colleges since it provides a snapshot in time rather than a cumulative figure. However, it is misleading because it does not differentiate among colleges according to loan volume. Consequently, a college with a very small GSL program may appear to have an enormous default problem. A case in point is one rural community college that was reported to have the highest default rate of any in California - a default rate of 82.4 percent based on 17 borrowers. According to federal calculations, community colleges in California have default rates ranging from 0 to 57.7 percent, with the exception noted above.

The Need for Immediate Action

Despite efforts to bring the GSL program under control, the situation is still critical and calls for immediate steps to be taken. Recent publicity reflects a growing tendency to link high GSL default rates with poor-quality education. Although groundless, such inferences are damaging to the public image of community colleges. Even more important, the U.S. Department of Education recently issued a Notice of Proposed Rulemaking (NPRM) to implement former Secretary Bennett's proposal to initiate limitation, suspension, and termination proceedings against any institution that fails to reduce student default rates below 20 percent by 1990. If this proposal is adopted, the federal government will have the authority to revoke an institution's eligibility to participate in all Title IV financial aid programs, not just the GSL program. According to the Department's calculations, 74 community colleges in California have default rates of 20 percent or higher. If the proposed policy were implemented today, these colleges would face the potential of losing all of their federal financial aid funds - an estimated loss of as much as $125 million annually. This potential threat to access for community college students in California is clearly unacceptable.

CONCLUSIONS

On the basis of its study, the Financial Aid Policy Task Force has identified the following factors as primary continuing contributors to the GSL default problem for California Community Colleges:

- Low-income students are compelled to rely on loans to finance their education because of inadequate funding for grant and work study programs. Unless the need for borrowing is reduced by redirecting financial aid resources, community colleges and other institutions that serve a high proportion of low-income students will continue to see high default rates.

- Borrowers who fail to complete their educational programs and secure gainful employment often are unable to repay their student loans when they come due. A significant number of community college borrowers who drop out during their first year can be expected to default.

- Because they are more readily available than other forms of financial aid, loans are attractive. Competition among lenders for student borrowers has encouraged development in electronic loan processing that minimize the waiting time between application and approval. The average time it takes to obtain other kinds of financial aid has lengthened annually since 1984-85.

- Because no eligible student can be denied a GSL, unwise borrowing can only be limited through counseling and other staff-intensive efforts. Community college financial aid offices do not have adequate staff resources to accomplish these activities.

- Students frequently enter repayment status and default when they transfer to another institution, are unemployed, or have other extenuating circumstances that would qualify them for temporary deferral of their repayment obligations. Such technical defaults occur because: (1) procedures for deferring payment are complex; (2) some lenders and secondary markets fail to effectively inform students of necessary steps to take to request deferral status; (3) students move frequently and fail to inform lenders of address changes; and (4) financial aid offices do not have sufficient staff to closely monitor students and assist them to fulfill deferral procedures.

- Colleges are being held responsible, inappropriately, for students who default. The U.S. Department of Education proposes to use GSL default rates as a measure of an institution's ability to administer all forms of federal financial aid. Recent restructuring of the GSL program has given educational institutions more responsibility for administering it, but no corresponding authority in loan origination. The performance of those who hold that authority - the lending institutions - is not measured on the basis of their default rates.

RECOMMENDATIONS

On the basis of these conclusions, the Financial Aid Policy Task Force urges the Chancellor to seek a commitment from the Board of Governors to assume a strong leadership role on behalf of California's community colleges for a policy to effectively resolve the GSL default problem. To that end, the Task Force offers the following short- and long-term, general and specific recommendations.

To make an immediate impact on rising GSL default rates and to respond to the proposals of the U.S. Department of Education, the Task Force recommends that the Board of Governors:

1. *Encourage districts to begin immediately to implement the provisions of SB 2555 for withholding school services to students who are in default. Further, colleges should be encouraged to publicize such action broadly, both on and off campus.*

2. *Encourage districts to provide training in basic loan administration, with emphasis on deferral procedures and default prevention, for all college personnel who interact with students in an advisory capacity, such as counselors, Transfer Center personnel, and instructors.*

3. *Encourage districts to prevent technical defaults through enhanced loan counseling and student follow up, to be provided by identifying resources to supplement current financial aid staffing.*

4. *Direct the Chancellor to prepare a response on behalf of the Board to the U.S. Secretary of Education regarding the proposed rules on GSL administration. The response should emphasize the following:*

    - *The Board of Governors shares the Secretary's deep concern about GSL default rates and is taking action to correct the situation in California's community colleges to the limit of its authority.*

    - *The Secretary's proposal to take LS&T action against schools solely on the basis of their default rates fails to recognize factors beyond institutional control that give rise to student defaults.*

    - *The Secretary's proposal to terminate institutional eligibility to participate in all Title IV financial aid programs inappropriately associates GSL defaults with the administrative capabilities of financial aid offices. The proposal is punitive rather than corrective and is unacceptable given the nation's commitment to equal educational opportunity.*

    - *Standards for program reviews triggered by institutional default rates should include criteria that recognize institutional efforts to reduce defaults, characteristics of the student body, and the economic and employment conditions within an institution's service area.*

- *Requirements for providing consumer information and for analyzing the causes of default should be deleted, recognizing that the primary causes of default are not institutional.*

- *Appropriate responsibility for preventing defaults should be placed on the lenders.*

As a long-term strategy for reducing student dependence on loans, and thereby limiting GSL defaults, the Task Force recommends that the Board of Governors:

5. *Continue its efforts to provide students from diverse backgrounds with the means to define their goals in attending community colleges and to achieve success in meeting those goals by:*

   - *Reaffirming the "open door" admissions policy for all California residents who can demonstrate the ability to benefit from a college education.*

     Recognizing that the vast majority of students who borrow to attend college do benefit from the education they receive, do repay their student loans, and do repay society for the opportunity they have been afforded, the Financial Aid Policy Task Force urges the Board of Governors to reaffirm its commitment to equal educational opportunity and to seek a solution to the problem of GSL defaults within that context.

     The Belmont Task Force cautioned in its final report in February 1988 that although denying loans for first-year students would accomplish a significant reduction in the default rate, without alternative forms of aid, "such an approach would effectively end the national policy of not having income as a barrier to attending college."[6]

   - *Continuing efforts to secure full funding for matriculation services to improve student retention.*

     To the extent that students can be helped to succeed in their educational endeavors through quality orientation, assessment, advisement, counseling, placement, and follow-up services, loan defaults can be prevented.

   - *Encouraging districts to evaluate the impact of matriculation on financial aid recipients as a component of local matriculation-evaluation plans.*

     There is evidence that suggests a positive correlation between student retention and financial assistance in the form of grants and work study that does not hold true for loans. Whether matriculation services can

6. Ibid, p. 11.

have a positive effect on the retention of student borrowers is a question that deserves further consideration.

- *To the extent that other resources are available to meet students' financial need, encouraging financial aid administrators to adopt packaging policies that limit GSLs for first-year students.*

  The Chancellor's Office policy that permits the substitution of an EOPS grant for a GSL in a student's financial aid package is an example of proactive default prevention. Other such approaches should be identified through consultation with financial aid professionals and publicized to encourage broader implementation.

6. *Seek and support initiatives that would increase federal funding for grant and work study aid as an alternative to loans for low-income students by:*

   - *Supporting federal initiatives to make the Pell Grant an entitlement program.*

     Pell Grant funding currently relies on annual appropriations that have never fully covered program costs called for in statutory provisions. As a result of annual shortfalls in funding, scheduled increases in the maximum amount of the Pell Grant have been delayed in past years, and a linear reduction in funding for 1985-86 eliminated some otherwise eligible students. It is ironic that the GSL is an entitlement program and the Pell Grant, designated for the neediest of students, is not.

   - *Seeking Congressional action to increase the proportion of educational costs covered by the Pell Grant.*

     The funding formula for this program currently provides for grant amounts that theoretically cover 60 percent of a student's educational costs. That amount is determined by a formula that restricts costs artificially, and maximum grant amounts for community college students actually represent a much smaller percent of real educational costs - approximately 16 percent, according to the Student Aid Commission. A substantial increase in Pell Grant funding would lessen reliance on loans to fill the gap between grants and the actual cost of attendance.

   - *Supporting annual budget initiatives to increase funding for the campus-based Supplemental Educational Opportunity Grant (SEOG) and College Work Study programs.*

     Funding for these federal programs has not increased significantly since the current Administration took office. Cost savings in these programs are more than offset by increased GSL costs in subsequent years.

7. *Seek and support initiatives at the state level that would increase financial aid funds for low-income community college students as an alternative to loans by:*

- *Supporting legislative and budgetary initiatives to increase the share of Cal Grant funds provided to community college students.*

  The Student Aid Commission is requesting funds in its 1989-90 budget for 1,500 new Cal Grant Bs, 51 percent of which would, by statute, go to community college students. The Board should support this budget proposal. It should be recognized, however, that substantially greater levels of grant funding are required to have any impact on the problem of unmet student financial need.

  The Cal Grant A, B, and C programs provided $132 million in financial aid to California students in 1987-88. Of that amount, only 9.8 percent ($12.9 million) was awarded to community college students. In contrast, 49 percent ($64.7 million) went to students attending four-year independent colleges and universities.[7]

  The average grant at four-year independent institutions is four times the average at community colleges because of differences in the cost of tuition and fees. Although one purpose of the Cal Grant programs is to allow students choice among postsecondary institutions, another purpose is to provide access for the large and growing number of low-income, disadvantaged students who, by and large, attend community colleges. Protecting choice among high-cost institutions should not mean that less than 10 percent of funding is dedicated to access. Some changes in the structure of the Cal Grant programs would be needed, in addition to an increase in Cal Grant funds, to make more aid available to community college students, particularly independent students who tend to default in larger numbers.

  As an alternative to expanding or redistributing Cal Grant funds, the Board might seek legislation to establish a new grant program for low-income community college students. With unmet financial need for this group estimated at $400 million, a substantial investment of state resources could be justified. This approach would raise additional policy considerations, however, such as who would administer the program; how many grants to fund and for what amount; and how to target awards to have the greatest impact on reducing loan defaults. Limiting new grant aid to first-year students might help students defer borrowing until their second year in college, when the likelihood of their completing an

7. Source: California Student Aid Commission Grant Program Statistics. Sacramento, 1987 88

educational program is increased. In discussing these issues with representatives of the other public segments of higher education, Chancellor's Office staff found that they are also concerned with the problem of first-year defaults and that the degree of support for an exclusively community college program is questionable. Staff of the Student Aid Commission have expressed a preference for working within the Cal Grant B program to increase financial aid to community college students.

- *Supporting budget initiatives to expand the State Work-Study Program.*

  This program was launched on a pilot basis in 1987-88 at 15 colleges, including 3 community colleges. It is designed to provide part-time work off campus and in the private sector, as well as on-campus employment. With no funding provided for expansion this year, it remains a pilot program. If adequately funded, including sufficient funding for job-development activities, the program could provide another alternative to loans for some students.

8. *Encourage community college districts to provide adequate administrative support for the operation of financial aid offices and assist them to obtain funds for that purpose by:*

   - *Urging the California Student Aid Commission to again seek funding to provide an administrative cost allowance for schools participating in the GSL program, and offering full Board support throughout the State Budget process.*

     The Student Aid Commission has acknowledged the workload implications of its Default Prevention Plan. To the extent that the time and energies of campus financial aid staff have been diverted to default-prevention activities, the delivery of other aid programs has suffered. An apparent decline in the number of Pell Grant recipients in 1987-88 may be attributable in part to the new GSL-related workload. This situation cannot be allowed to continue.

   - *Seeking action to have the U.S. Department of Education establish an administrative cost allowance for the GSL program.*

     Small administrative allowances are provided to colleges that administer the Pell Grant and campus-based federal aid programs. Although these allowances represent less than 10 percent of the total administrative funding for financial aid offices, their contribution to district operations is essential. Since 1986, the federally mandated workload for GSL processing has increased dramatically and the associated costs should be compensated.

- *Encouraging districts to consider allocating a portion of their program-improvement funds to financial aid administration, particularly at colleges with high default rates.*

  With adequate staffing, some actions could be taken to have an immediate impact on a college's default rate, particularly in avoiding procedural defaults.

- *Affirming the charge of the Financial Aid Policy Task Force to examine the issues of financial aid workload, resources, and unmet financial need.*

  Beyond obtaining increased non-loan funding as an alternative to the GSL, financial aid offices must have the administrative capacity to deliver those funds to students. A full examination of barriers to delivery is warranted.

APPENDIX

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FEB 10 1989